for regulatory accounting adherence to GAAP.[54] The failure to recognize the expenses as incurred is contrary to GAAP and results in the cost of the litigation being held in abeyance, thus affecting ratepayers several years after the expense was incurred.

In rejecting the deferral approach in 1987 the Commission noted that a major problem was that deferred costs may remain in the deferral account for lengthy periods of time given the time necessary to finally resolve litigation.[55] The Commission has previously recognized the pitfalls of expense deferral over such a long period of time because of the "uncertainty in the financial community as to the profitability of the carrier and its ability to recover costs which may well later be shown to have been prudently incurred."[56] This same concern logically applies to the regulated books. It is not reasonable to cause the same uncertainty among ratepayers and regulators regarding unnecessarily deferred expenses. This becomes even more questionable when, as previously noted, the FCC has stated its intent to mirror the regulatory books to the financial books - i.e., adopt GAAP. Adopting a different set of accounting standards for this issue adds a complexity to the accounting systems that is unnecessary and confusing. The Commission also acknowledged that the deferral approach was inconsistent with its recognition that incurrence of litigation

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[54]See, In the Matter of Revision of Uniform System of Accounts for Telephone Companies to accommodate Generally Accepted Accounting Principles, 102 FCC 2d 964 (1985).

[55]1986 Litigation Costs Order, 2 FCC Rcd. at 3247.

[56]Id.

expenses are not unusual. Thus the Commission declared that "accordingly (we) believe it to be counterproductive to amend our accounting classifications to impose the deferral approach on all carriers for all antitrust proceedings".[57]

Nothing has changed since the Commission rejected the deferral approach in its 1986 Litigation Cost Order to justify a reversal of that Order by the Commission. The proposed deferral approach should be again rejected.

B. The Proposed Deferral Method Fails to Consider the Perverse Litigation Incentives It Creates or the Extreme Administrative Burdens and Cost Involved in Tracking Such Expenses.

The true beneficiaries of the proposed litigation expense tracking and deferral methodology outlined in the NPRM are opposing attorneys who will know that the quickest way to hamstring a carrier's defense of a suit by tying up resources or otherwise diverting counsel's attention from the true issues in a case will be to allege, if at all possible, an antitrust violation or some other violation of federal law. Recovery is seldom sought on a single count--rather the complaint, petition or counterclaim will allege a multitude of allegations and alternative theories of recovery. The threat of bringing an antitrust or federal law claim will be used by opposing counsel as a weapon to try and force a settlement. By including an allegation of violation of antitrust law or some other federal statute, the opposing attorneys can be assured that time and expenses otherwise available to fight the

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[57] 1986 Litigation Costs Order, 2 FCC Rcd. at 3247.

litigation will be used to document and determine what time and effort is going to defend the non-statutory counts as compared to the statutory claims.

The adverse incentive created by the rule hurts not only the carrier in litigating the suit but also the ratepayer because these artificial costs of sorting through bills, tying research to specific claims and attempting to allocate costs such as discovery, depositions and travel among the various allegations may ultimately be included in above-the-line accounts. Thus, in determining the nuisance value, another factor will be the cost of having to sort out and allocate the expenses, again serving no purpose except as a windfall to the opposing attorney by raising the settlement value of the litigation.

For example, an opposing attorney, upon realizing the existence of the presumptions and tracking rules, would recognize the advantage in amending an existing breach of contract claim to include allegations of violations of antitrust or federal statutes.[58] The opposing attorney would most likely threaten the amendment first in an attempt to induce a more favorable settlement. If the carrier refuses to settle then the opposing

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[58]If in Federal Court, the attorney would be bound by Rule 11 of the Rules of Civil Procedure which would impose a presumption that by signing the pleading, the attorney certifies that the pleading is well founded in fact and warranted by existing law or a good faith argument for the extension, modification or reversal of existing law and is not being imposed for any improper purpose. The Courts have recognized, however, that Rule 11 sanctions should be sparingly imposed and care taken to avoid chilling creativity or stifling enthusiasm. Securities Industry Association v. Clarke, 898 F.2d 318 (2nd Cir. 1990).

attorney would file the amendment adding antitrust or federal statutory claims. Because of the proposed rules, the opposing attorney by filing the amendment gains an advantage by forcing the carrier to establish a methodology for determining and categorizing how common costs such as travel, research, court appearances, deposition time and all other time and expense should be separated between the various counts.[59] The opposing attorney, through the rules, also forces the carrier, after the separation methodology is established, to spend time and money each month tracking the costs and reviewing outside counsel bills to determine how the time and expense fit into the categories. By filing the amendment the opposing attorney has greatly increased the cost of the carrier to litigate the suit and the nuisance value of settling the case. The opposing attorney has also increased the attractiveness of settling the case to the carrier.

The carrier, however, may decide to continue fighting the antitrust or federal statutory claims in the amendment. During the fight the carrier would expend countless time and money separating and categorizing the costs, including common costs, between the various counts and suits. If the carrier is successful in defeating the federal counts, whether by motion to dismiss, summary judgment or at trial, all of the expense related to the antitrust

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[59]The accounting may become even more difficult if the carrier has similar issues filed against it in other suits which do not include allegations of a violation of a federal statute. In addition, the opposing counsel may believe that additional pressure to settle may come if claims are brought against employees of the corporation in their personal capacity and against affiliates of the carrier, thus causing more tracking and accounting nightmares.

or federal counts, in addition to the cost of separating the costs, would be placed in above-the-line accounts, to the detriment of the ratepayer.

This is a prime example of not only the expense and burden associated with having to track such costs but also the perverse incentive it has on the litigation to the determent of the ratepayer. In some cases, the opposing attorney's underlying motive in bringing the antitrust or federal claim, or a common law claim if the primary claim is based on a statutory violation, might well be to take advantage of the complexity and possible increased nuisance value caused by the rules--in absence of the rules the antitrust or federal claims, or the common law claim, might never have been filed.[60] Thus the rules create a windfall for the opposing attorney to the detriment not only of the carrier but also the ratepayer.

In addressing the tracking requirements in the 1986 Litigation Cost Recon. Order, the Commission reasoned that "companies routinely track certain litigation expenses and use that data in assessing settlement possibilities".[61] This statement is not accurate. Carriers may track litigation costs by individual cases or through outside counsel bills, however expenses are not normally tracked based on specific allegations in the litigation.

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[60]The claims might never have been filed because the chances of ultimate recovery are outweighed by the time and effort needed to prove the claim. The rules however add an incentive to file the claims which would otherwise be absent.

[61]1986 Litigation Cost Recon. Order, 4 FCC Rcd. at 4099.

The Commission should not adopt rules which will add artificial incentives to the litigation equation, especially when the incentives are a windfall to opposing counsel to the detriment of both the carrier and the ratepayer. The balance sheet deferral proposal for tracking litigation costs should again be rejected.

C. Litigation Costs are A Normal Part of Conducting Business.

The simple fact remains that litigation expenses are a normal part of conducting business. This fact has been acknowledged by the Commission[62], discussed at length by the carriers in the 1986 Litigation Costs Proceedings and by the Circuit Court of Appeals for the District of Columbia in the Litton Decision.[63]

The United States Supreme Court has recognized that a dentist's litigation expenses in an unsuccessful defense of fraud in advertising the cost of his services was an ordinary and necessary business expense.[64] Likewise, the Supreme Court determined that a securities dealer's litigation expenses in an unsuccessful defense of securities and mail fraud charges were ordinary business expenses.[65] Thus, as the Litton Decision notes, the Commission's success-failure of litigation standard as the sole

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[62]Litton Order, 98 FCC 2d at 984.

[63]Litton Decision, 939 F.2d at 1034.

[64]Commissioner v. Heininger, 320 U.S. 467 (1943).

[65]Commissioner v. Tellier, 383 U.S. 687 (1966).

determinative factor for the presumption that litigation costs are not ordinary costs of operating the business has met disfavor in similar contexts.[66]

As noted in Sections I and II above, the main problem with the presumption is that it ignores the established standard of reasonableness of the expenditure. The mere fact that a judge or jury determined that some conduct by the carrier's employees violated a statute does not mean that the employees acted imprudently or in bad faith, let alone that the carrier's decision to defend itself was unreasonable. Litigation costs are a normal part of conducting business and should be included in above-the-line accounts.

VI. THE PRESUMPTION SHOULD NOT BE EXTENDED TO VIOLATIONS OF OTHER FEDERAL STATUTES.

The NPRM tentatively concludes that the presumption of disallowance should also apply to adverse judgments, settlements and expenses arising out of actions based on violations of yet unchosen federal statutes.[67] The NPRM justifies its conclusion again on the assumption that if there is an adverse judgement concerning a violation or a settlement for more than nuisance value the action giving rise to the suit could not have benefitted the ratepayer.[68] As discussed above,[69] the "post-litigation/benefit

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[66]Litton Decision, 939 F.2d at 1032.

[67]NPRM, at paras. 22-25.

[68]NPRM, at para. 22.

the ratepayer" test should not be used to create a presumption about the employees' prudence or good faith at the time of the action or the carrier's decision to defend itself. Rather, the Commission should continue to use the traditional test of reasonableness.

Further, as the Court of Appeals noted in the Litigation Costs Decision, in overturning similar rules, Congress has not expressly given the FCC the power, particularly its ratemaking power, to deter violations of federal statutes generally.[70] As the Commission admitted during the 1986 Litigation Costs appeal, it "does not enforce the vast majority of federal statutes and has no office in the deterrence of conduct that violates this statute."[71]

The NPRM proposes two options for implementing its tentative conclusion. The first option would be that the Commission would review on a case-by-case basis the circumstances of any lawsuit involving a federal claim in which a settlement or judgment exceeded a threshold amount.[72] The second option would consist of the Commission selecting certain federal statutes which would be treated in the same manner as proposed for antitrust judgments. Of the two options, the first resembles the traditional

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[69]See, Sections II and III, supra.

[70]Litigation Costs Decision, 939 F.2d at 1044. (emphasis added).

[71]Brief of Respondents, p. 28, Mountain States Telephone & Telegraph v. Federal Communications Commission, 939 F.2d 1035 (D.C. Cir. 1991).

[72]NPRM, at para. 24.

test in that the Commission will be reviewing the conduct on a case-by-case basis instead of creating a difficult to rebut presumption.

The first option however would create a tremendous problem, as discussed above in Section V, if the Commission requires the litigation costs associated with the alleged violation to be separately tracked and placed in a deferral account. The NPRM apparently realizes the problems tracking costs on all federal allegations would cause and proposes three alternatives for treatment of litigation expenses related to lawsuits subject to case-by-case review.[73] The third alternative, to allow above-the-line accounting is the only alternative which would not cause the administrative burden and adverse, artificial incentives to litigation described in Section V above, which ultimately would harm the ratepayer. Similarly, the Commission should also allow above-the-line accounting for antitrust litigation expenses to avoid the same administration burdens and perverse incentives to litigation.

VII. CONCLUSION

The changes proposed by the NPRM work primarily to frustrate carriers' litigation efforts by creating artificial incentives to the detriment of the carrier and the ratepayer. As this Commission recognized in 1982 the traditional established standards for treating litigation costs are adequate to protect the

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[73] NPRM, at para. 24.

ratepayer. Further, the established standards do this without creating perverse incentives in the litigation environment, windfalls for opposing attorneys and their clients and burdensome and costly tracking methodologies which end up harming the ratepayer. The proposals contained in the NPRM should be rejected.

Respectfully submitted,

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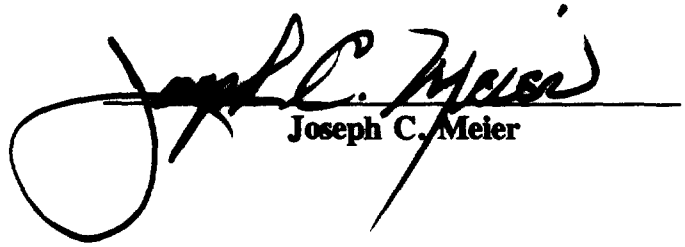
CERTIFICATE OF SERVICE

I, Joseph Meier, hereby certify that the foregoing "Comments of Southwestern Bell Telephone Company", in CC Docket No. 93-240, has been served this 15th day of September, 1993 to the Parties of Record.



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